Petition

81-302

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NO. .....

IN THE

Supreme Court of the United States

OCTOBER TERM, 1981

GEORGE M. JONES, ET AL
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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August 17, 1981

QUESTIONS PRESENTED FOR REVIEW

1. Whether expenses incurred by the corporate general partner of a limited partnership in carrying on the partnership's business are deductible for income tax purposes by the partnership on behalf of which such expenses were incurred or by the corporate general partner.

2. Whether income and expenses of a limited partnership having a corporation as its general partner are to be taxed to the corporate general partner because it held bare legal title to partnership property rather than to the partnership which admittedly held equitable title to the property.

3. Whether income and expenses of a limited partnership are to be taxed to its corporate general partner, rather than to the partnership, because the general partner's capacity as partner was undisclosed.

4. Whether the decision of the Court of Appeals in this case applying six standards borrowed from the *National Carbide* case[1] to determine the existence or non-existence of a partnership for tax purposes, conflicts with the decision of this Court in the *Culbertson* case[2] which held that the existence or non-existence of a partnership is to be determined by the good faith intent of the parties.

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1 *National Carbide Corporation v. Commissioner of Internal Revenue*, 336 U.S. 422, 69 S.Ct. 726, 93 L.Ed. 779 (1949).
2 *Commissioner v. W. O. Culbertson*, 337 U.S. 733, 69 S.Ct. 726, 93 L.Ed. 1659 (1949).

PARTIES TO THE PROCEEDING

The parties to the proceeding are:

1) George M. and Jean H. Jones,
Donald E. and Carol J. McGuire
Charles M. and Julia I. Wilson
Shields O. and Harriette L. Livingston
Robert G. and Francoise B. Long,

Petitioners,

2) Commissioner of Internal Revenue,

Respondent.

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Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Petitioners pray that a Writ of Certiorari be issued to review the judgment and opinion of the United States Court of Appeals for the Fifth Circuit entered in this proceeding on March 27, 1981.

OPINIONS BELOW

The decision of the United States Court of Appeals is officially reported at 640 F.2d 745 and appears as Appendix A hereto. The opinion of the Tax Court is officially reported at 37 TCM 1847-24 and appears as Appendix B hereto.

JURISDICTION

The judgment of the United States Court of Appeals was entered on March 27, 1981. Petitioners' Motion for Rehearing of the decision was overruled on May 19, 1981 (see Appendix C). This Petition for Certiorari was filed within ninety (90) days of that date. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

Internal Revenue Code of 1954, § 761 (26 U.S.C. 761):

> (a) Partnership. — For purposes of this subtitle, the term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title [subtitle], a corporation or a trust or estate. Under regulations the Secretary may, at the election of all the members of an unincorporated organization, exclude such organization from the application of all or part of this subchapter, if it is availed of —
>
> (1) for investment purposes only and not for the active conduct of a business,
>
> (2) for the joint production, extraction, or use of property produced or extracted, or

(3) by dealers in securities for a short period for the purpose of underwriting, selling, or distributing a particular issue of securities,

if the income of the members of the organization may be adequately determined without the computation of partnership taxable income.

(b) Partner. — For purposes of this subtitle, the term "partner" means a member of a partnership.

(c) Partnership Agreement. — For purposes of this subchapter, a partnership agreement includes any modifications of the partnership agreement made prior to, or at, the time prescribed by law for the filing of the partnership return for the taxable year (not including extensions) which are agreed to by all the partners, or which are adopted in such other manner as may be provided by the partnership agreement.

(d) Liquidation of a Partner's Interest. — For purposes of this subchapter, the term "liquidation of a partner's interest" means the termination of a partner's entire interest in a partnership by means of a distribution, or a series of distributions, to the partner by the partnership.

(e) Cross Reference. — For rules in the case of the sale, exchange, liquidation, or reduction of a partner's interest, see § 704(b) and 706(c)(2).

STATEMENT OF THE CASE

Taxpayers formed a limited partnership for the purpose of constructing apartments. Faced with the need of borrowing money at rates of interest greater than permitted by Texas usury laws to be charged to individuals, and in order to comply with such usury laws, the parties executed Amended Articles of Limited

Partnership naming Mateo Corporation as an additional general partner.[3]

The Court of Appeals recited facts as follows:

> The corporation made no capital contribution to the partnership. The corporation had the sole authority to execute contracts and change orders with respect to the construction of the apartments. The corporation also had authority to make all decisions concerning the operation and management of the apartments and to employ agents and other third parties on behalf of the partnership. Title to all partnership property was to stand in the corporation's name without disclosure of the fiduciary capacity in which it held the property. The corporation was given authority to execute loan documents for interim and permanent financing in its own name without disclosing the fiduciary capacity in which it was acting. In return for these services to the partnership, the corporation was to receive 30% of the partnership's net profits, excluding capital gains. The corporation was not to share in any of the partnership's losses, and all partnership losses were to be carried forward without limit as to time in determining the corporation's share of the net profits. (640 F.2d, at 748)

The corporate general partner proceeded to arrange financing and construct the apartment.

The issue presented was whether certain losses and expenses incurred in connection with the activities of the corporate general partner on behalf of the partnership were taxable to the corporate general partner or

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3 Excerpts from the Articles of Limited Partnership are set out in footnote 7 to the Court of Appeals' opinion (at 748).

to the partnership and its partners according to the terms of its Articles of Limited Partnership.

The Tax Court found that the partnership existed and that the Mateo Corporation was a general partner (37 TCM 1847-26, 29). That finding was not disturbed by the Court of Appeals (640 F.2d, at 752).

Notwithstanding its conclusion that a partnership existed, the Tax Court held that expenses and losses incurred on behalf of the partnership were taxable to the corporate general partner rather than to the partnership.

The Court of Appeals, exercising jurisdiction under 26 U.S.C. 7482(a), affirmed.

REASONS RELIED ON FOR THE ALLOWANCE OF THE WRIT

The issue presented to the Court of Appeals was whether or not a bona fide partnership existed.

The standards for determination of the existence or non-existence of a partnership for tax purposes were established by this Court in *Commissioner v. W. O. Culbertson*, 337 U.S. 733, 69 Sup.Ct. 726, 93 L.Ed. 1659 (1949) and *Commissioner v. Tower*, 327 U.S. 280, 90 L.Ed. 670, 66 S.Ct. 532 (1946).

The standards for determination of the existence of a partnership as established by the *Culbertson* case are:

> . . . *whether*, considering all the facts — the agreement, the conduct of the parties in execution of its provisions, their statements, the testimony of disinterested persons, the relationship of the parties, their respective abilities and capital contributions, the actual control of income and the purposes

> for which it is used and any other facts throwing light on their true intent — *the parties in good faith and acting with a business purpose intended to join together in the present conduct of the enterprise.* (337 U.S. 742-3, emphasis added)

The Fifth Circuit, in *Bayou Verrett Land Co., Inc. v. Commissioner*, 450 F.2d 850 (5th Cir., 1971) relying on the *Culbertson* case, held that the crucial question of whether a partnership existed for income tax purposes depended upon " 'whether the partners really and truly intended to join together for the purpose of carrying on business and sharing in the profits or losses or both' ". (at 863) The Court of Appeals further stated:

> . . . a finding or conclusion on intent is a prerequisite to the resolution of whether a partnership existed for purposes of the income tax laws. (at 863)
>
> . . . the ultimate question remains not whether the creation of the partnership was motivated in part by family ties but whether the intent necessary to create a valid partnership was present or absent. (at 864)

But when, in this case, the Court of Appeals addressed itself to the question of whether a bona fide partnership existed or not, it ignored the standards enunciated in the *Culbertson* case and its own opinion in the *Bayou Verrett* case. It did not address itself to the good faith intentions of the parties or even to the existence or non-existence of the partnership but, instead, attempted to apply standards from *National Carbide Corporation v. Commissioner*, 336 U.S. 422, 69 S.Ct. 726, 93 L.Ed. 799 (1949). The *National Carbide* case was of little assistance in reaching a con-

clusion as to whether or not a partnership existed. *National Carbide* did not involve a partnership at all. It involved the question of whether or not profits of a corporation should be taxed to its shareholders (rather than to the corporation) under a claimed agency arrangement. This Court pronounced six standards to aid in determining whether such an agency existed. Such standards are appropriate to determine whether a corporation is the agent for its stockholders, but they provide little guidance in determining whether a partnership existed or not.

Nevertheless, the Court of Appeals, without inquiring whether the partners in good faith intended to join together in a partnership, attempted to apply the *National Carbide* standards to determine the existence or non-existence of the partnership. It eliminated one of such standards as not being pertinent. The other five standards it adapted and paraphrased to give them relevance to the partnership question instead of the agency question for which such standards were devised.[4]

In effect, the Court of Appeals held that income and expenses arising out of a general partner's activities on behalf of a bona fide existing partnership may nevertheless be taxable to the general partner rather than

4 The Court of Appeals also relied on *Moline Properties v. Commissioner*, 319 U.S. 436, 63 S.Ct. 1132, 87 L.Ed. 1499 (1943) and *Collins v. United States*, 386 F.Supp. 17 (S.D.Ga., 1974) *aff'd*, 514 F.2d 1282 (5th Cir., 1975), neither of which involved a partnership. Both cases presented a taxpayer's plea that a corporation should be ignored as a taxpayer entity because it was a "sham", a "fiction" and "without substance". The corporation in this case was real, of substance and active in the discharge of its contractual duties as a general partner of the partnership.

the partnership. This startling consequence has not been urged since 1938 when the Service abandoned its efforts to have income and deductions of a partnership taxed to the partner in whose name partnership property was held.[5]

Thus, the decision of the Court of Appeals in this case conflicts with this Court's holding in the *Culbertson* case and with the Court of Appeals' own earlier decisions in the *Bayou Verrett* case, supra, and in *Powell v. Commissioner*, 256 F.2d. 941 (5th Cir. 1958) and *James v. Commissioner*, 197 F.2d 813 (5th Cir. 1952). The decision of the Court of Appeals is also in sharp conflict with the decisions of other circuits which have adhered to the standards for determination of the existence of a partnership established by this Court in the *Culbertson* case.[6]

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5 In the 1920's the Service repeatedly asserted that if legal title to property was held on behalf of a partnership in the name of one of the partners, all deductions would flow to the partner who held the legal title. The courts uniformly rejected this argument and the Commissioner acquiesced in these decisions. See for example *Lewis Dill* decided by the Board of Tax Appeals in 1925, 3 BTA 65 (1925) Commissioner Acquiesces IV-2 CB 2. To the same effect see *Frank E. Eyestone*, 12 BTA 1232 (1928) Commissioner Acquiesces VII-2 CB 12; *W. H. Simmons*, 22 BTA 1106 (1931) Commissioner Acquiesces X-2 CB 65; *Theodore Levin*, 7 BTA Memorandum Decisions, § 38105 (1938). With the *Levin* case the Service seems to have abandoned its efforts to tax partnership income and losses to a partner rather than to the partnership.

6 See for example:

First Circuit:	Barrett v. Commissioner, 185 F.2d 150 (1950)
Second Circuit:	Dyer v. Commissioner, 211 F.2d 500 (1954)
Third Circuit:	Eisenberg v. Smith, 263 F.2d 827 (1959)
Fourth Circuit:	Roughan v. Commissioner, 198 F.2d 253 (1952) Feldman v. Commissioner, 186 F.2d 87 (1950)

Moreover, the incorrect decision of the Court of Appeals casts a pall of uncertainty over a huge area of business taxation. It is said that the partnership is the most numerous form of business enterprise. The Court can take note of its popularity as a business vehicle in all types of ventures, and particularly in connection with syndications, real estate development ventures, and oil and gas exploration ventures. The Court is also aware of the frequent use of corporate partners and corporate general partners in connection with ventures in which the risk of liability is high.

For four decades these ventures have trod on stable tax ground; if they were bona fide partnerships and successfully avoided the pitfalls of becoming taxable as an association, they were secure in their tax treatment: The partners would be taxed on the profits and losses of the partnership in accordance with their respective interests or their articles of partnership.

If the decision of the Court of Appeals is allowed to stand every partnership will be imperiled. Every partnership will be forced to review not only its articles of partnership but its business procedures and activities as well, and to test them by each of the six "standards" used by the Court of Appeals in this case. Those who have completed their business purpose, or have progressed substantially in that direction, may be powerless to help themselves. Adverse tax treatment may be visited upon them because they could not and did not

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Eighth Circuit: Smith's Estate v. Commissioner, 313 F.2d 724 (1963)
Lannan v. Kelm, 221 F.2d 725 (1955)
Boyt v. Commissioner, 209 F.2d 839 (1954)
Kasper v. Baron, 207 F.2d 744 (1953)

Ninth Circuit: Poggetto v. United States, 306 76 (1962)

anticipate that their tax treatment would be determined by six standards borrowed and reconstructed from a case that did not even involve a partnership.

In summary, the Court of Appeals was confronted by (i) a formally organized and functioning corporation, (ii) acting as general partner of a limited partnership pursuant to formally executed Articles of Limited Partnership to which it was a party, (iii) actively engaged in carrying out the business venture of the limited partnership on behalf of the partnership, (iv) with no question concerning its valid business purpose or the good faith intention of the parties to join together as partners. Notwithstanding those indisputable facts the Court of Appeals ignored the standards of the *Culbertson* case, and resorting to the *National Carbide* case, which was wholly dissimilar, determined that the income and expenses of the partnership were taxable — not to the partners — but to the general partner.

CONCLUSION

For the reasons stated a Writ of Certiorari should issue to review the Judgment and Opinion of the Circuit Court of Appeals for the Fifth Judicial District.

Respectfully submitted,

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August 17, 1981

CERTIFICATE OF SERVICE

I hereby certify that on this 17th day of August, 1981, three copies of the Petition for Writ of Certiorari were mailed, postage prepaid, to Mr. M. Carr Ferguson, Assistant Attorney General, Tax Division, by depositing them in the United States Mail, addressed to him at the United States Department of Justice, Washington, D.C. 20530.

GEO. GARRISON POTTS

George M. and Jean H. JONES, Donald E. and Carol J. McGuire, Charles H. and Julia I. Wilson, Shields O. and Harriette L. Livingston, and Robert G. and Francoise B. Long,

Petitioners-Appellants,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellee.

No. 79-1420

United States Court of Appeals,
Fifth Circuit.

March 27, 1981.

Rehearing and Rehearing En Banc
Denied May 19, 1981.

H. David Herndon, George Garrison Potts, Claude R. Wilson, Jr., Dallas, Tex., for petitioners-appellants.

M. Carr Ferguson, Asst. Atty. Gen., Tax Div., U. S. Dept. of Justice, Wash., D. C., Gilbert E. Andrews,

Acting Chief, Appellate Section, Robert A. Bernstein, Gilbert S. Rothenberg, Stuart E. Seigel, Chief Counsel, I. R. S., Washington, D. C., for respondent-appellee.

Appeal from the Tax Court of the United States.

Before HILL, RUBIN and ANDERSON, Circuit Judges.

R. LANIER ANDERSON, III, Circuit Judge:

Taxpayers appeal a decision of the Tax Court upholding the Commissioner's assessments of deficiencies in their federal income tax. Taxpayers argue that the Tax Court erroneously concluded that taxpayers failed to prove the normal incidents of agency between a controlled corporation and a limited partnership in which they were partners. They maintain that the criteria formulated in *National Carbide Corp. v. Commissioner of Internal Revenue*, 336 U.S. 422, 69 S.Ct. 726, 93 L.Ed. 779 (1949), for determination of the agency status of a corporation have been met. We agree with the Tax Court that taxpayers have not carried their burden of proof, and therefore we affirm.

FACTS

The facts of this case are essentially undisputed. In 1969, taxpayers formed a limited partnership, San Mateo Properties, Ltd. (hereinafter referred to as Mateo Partnership or simply as the partnership), for the purpose of developing and operating an apartment

complex in the Dallas, Texas, area.[1] Dr. George M. Jones had acquired the land by 1971 and contributed it to the partnership. In exchange for this contribution, Dr. Jones became general partner, receiving a 75% interest in the profits and losses of the partnership. The remaining taxpayers contributed money to the partnership and each received, as a limited partner, a 5% interest in the partnership profits and losses.

In 1971, Mateo Partnership began the task of securing permanent financing for the complex. A mortgage broker placed the partnership in contact with First Mortgage Investors of Miami, Florida ("FMI"), and Lakewood Bank and Trust ("Lakewood"). During negotiations, the lending institutions informed Dr. Jones that they would be unable to consummate the permanent loan commitments with the partnership since the usury laws of Texas limited interest rates to individuals and partnerships. The lending institutions agreed to make the loan only to a corporation. In light of this information, the application for permanent financing to FMI was made in February, 1973, in the name of San Mateo Properties, Inc. (hereinafter referred to as Mateo Corporation or simply as the corporation), even though the corporation had not yet been formed. In March, 1973, FMI thereupon executed a permanent loan commitment in the name of the corporation, to be guaranteed by Dr. Jones. Three amendments to this permanent loan commitment were made shortly thereafter, all in the name of the corporation. A letter of credit was obtained from Lakewood to make up the

1. Taxpayers Shields O. Livingston and Donald E. McGuire became limited partners of the partnership for the first time during the taxable year 1973. An additional limited partner did not join in this suit.

projected deficit in the permanent loan commitment from FMI.

After permanent financing had been secured, Mateo Partnership sought interim financing through a second mortgage broker. This broker placed the partnership in contact with Texas Bank and Trust ("Texas Bank"). The loan application to Texas Bank was in the name of the partnership. Texas Bank approved the interim financing, but on condition that the loan would be made to a corporation and not to the partnership. The loan officer in charge of this loan testified that, at the time the application was made, he understood that the corporation was in existence or would be formed. He also testified that he did not know whether the corporation was acting as agent for the partnership.

On June 1, 1973, the corporation signed[2] a promissory note to Texas Bank in the amount of $2,700,000. This loan was guaranteed personally by Dr. Jones and his wife.

In conjunction with this loan, Dr. Jones entered a construction contract on June 1 with Campbell Bros., Inc. The contract indicated that Dr. Jones personally owned the land, without any indication that the property was owned either by the partnership or the corporation. At Texas Bank's requirement, this contract was reframed to be between Campbell Bros. and the corporation. Because the contract price and certain allowances were considered too high, Texas Bank required another contract be entered between the corpo-

2. Where we indicate the corporation signed a document, it is always by Dr. Jones. Dr. Jones occasionally would indicate his position as president and occasionally would not.

ration and Campbell Bros. adjusting the price and allowances.[3] Unknown to Texas Bank, Dr. Jones and Campbell Bros. entered a letter agreement on July 20, 1973, indicating they both considered the original contract to be the only valid contract between them.

On June 26, 1973, Dr. Jones and the limited partners formed Mateo Corporation. The business purpose of the corporation was broad and was not limited to functioning as a partner. Dr. Jones and the limited partners became the sole shareholders of the corporation[4]. The sole officers and directors of the corporation were Dr. Jones, Dr. Jones' wife and a limited partner.

At the first meeting of the Board of Directors on June 29, 1973, three resolutions were adopted authorizing Mateo Corporation to join Mateo Partnership as general partner, to enter into a construction contract with Campbell Bros., and to borrow money for interim financing from Texas Bank. The latter two resolutions did not disclose the corporation's capacity as general partner.

On the same days as the first meeting of the Board of Directors of Mateo Corporation, the Mateo Partnership agreement was amended to admit Mateo Corporations as an additional general partner.[5] The corporation

3. The two construction contracts entered into by the corporation were also dated June 1, 1973, although it is clear that they each were executed several days apart.

4. The corporation's tax returns indicate Dr. Jones owned 80% of the stock.

5. There is no indication in the record that an amended certificate of limited partnership showing the corporation as general partner was ever filed in the public records. *See* Tex. Civ. Code Ann. Art. 6132a, § 3(a) (Vernon 1970).

made no capital contribution to the partnership. The corporation had the sole authority to execute contracts and change orders with respect to the construction of the apartments. The corporation also had authority to make all decisions concerning the operation and management of the apartments and to employ agents and other third parties on behalf of the partnership. Title to all partnership property was to stand in the corporation's name without disclosure of the fiduciary capacity in which it held the property. The corporation was given authority to execute loan documents for interim and permanent financing in its own name without disclosing the fiduciary capacity in which it was acting. In return for these services to the partnership, the corporation was to receive 30% of the partnership's net profits, excluding capital gains.[6] The corporation was not to share in any of the partnership's losses, and all partnership losses were to be carried forward without limit as to time in determining the corporation's share of net profits.[7] By a deed dated July 2, 1973, the

6. The remaining partners' shares in net profits were adjusted to pro rata shares of the remaining 70% of net profits.

7. The pertinent provisions of the amended partnership agreement affecting the corporation's powers and compensation read:

7.1 *Construction and Management of Apartments.* The Corporate General Partner agrees to construct, or cause to be constructed, upon the Partnership's real estate, apartment buildings and related buildings and improvements substantially in conformity with plans and specifications which have been prepared, as the same may be changed or modified hereafter, and upon completion of such apartments and improvements to operate, manage, rent, lease, and maintain such improvements. The Corporate General Partner shall have the sole power and authority to execute contracts, change orders, and all other documents as may be necessary or convenient to construct such improvements on the real

partnership conveyed the realty to the corporation, without disclosure of the fiduciary capacity of the corporation.

On July 20, 1973, the first advance on the interim loan was made to Mateo Corporation and construction began. In the course of the construction, numerous change orders in the design were executed, which reflected the corporation as the owner.

During 1974 and 1975, while the complex was being built, Texas Bank would present on a monthly basis interest costs to Dr. Jones in his capacity as president of the corporation. Texas Bank would lend additional amounts to the corporation to satisfy the interest payments by depositing the appropriate amount each month in the corporation's account. Dr. Jones would then issue a corporate check payable to Texas Bank in the amount of interest due that particular month.

All did not go well with the construction of the complex. On January 10, 1975, after Campbell Bros. had

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estate owned by the Partnership. The Corporate General Partner shall have the power and authority to make all decisions concerning acquiring the real estate, zoning plans with architects and other consultants, constructing, closing, operating and managing the apartments project, and to employ such agents, consultants or third parties as in the unrestricted judgment of the Corporate General Partner may be necessary or convenient to construct and operate the apartments, and to pay such agents, consultants and third parties reasonable and customary fees or other compensation.

7.2 *Title to Partnership Propetries.* The title to all partnership property, real, personal and mixed, wherever located, shall be vested and stand in the name of the Corporate General Partner, without disclosing the fiduciary capacity in which it holds said properties.

7.3 *Financing.* The Corporate General Partner shall have the right to borrow, for and on behalf of the Partnership, in its own name or in the name of the Partnership, as it may

not completed the complex on schedule, Mateo Corporation informed Campbell Bros. and the surety company that it intended to take over the construction site in seven days. On January 13, 1975, the corporation advised the surety company that Campbell Bros. was in default, and requested the surety to perform its obligations under the performance bond. Evidently, the surety company refused to complete the project. Mateo Corporation thereupon borrowed an additional $1 million from Texas Bank and secured an extension on repayment of the original loan. These additional documents were executed by the corporation. On October 9, 1975, Texas Bank sent a letter to the corporation declaring the interim loans in default and initiating foreclosure proceedings.

Despite the difficulties in completing the complex, some apartments were nevertheless leased. These leases were with Mateo Partnership and rents were deposited in Mateo Partnership's account. Operating expenses for the complex were paid by the partnership.

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elect, such sums of money, from time to time, as the Corporate General Partner shall deem necessary or convenient to
1 enable it to construct, equip and furnish the proposed improvements and to operate the same, which borrowings may be interim, stand-by, or permanent, and may be for such periods of time and in [sic] at such interest rates and upon such other terms as the Corporate General Partner, in its sole discretion, shall determine. To secure payment of such sums, the Corporate General Partner may give and grant, for and on behalf of the partnership, in its own name, without disclosing the fiduciary capacity in which it acts, or in the partnership name, as it may elect, such deeds of trust, mortgages, pledges, security agreements, mortgage assignments, indentures, and other security agreements and assurances as may be reasonably necessary or convenient to obtain and secure such borrowings. All such borrowings may be refinanced by the Corporate General Partner from time to time as it shall deem appropriate.

For the tax years 1973, 1974 and 1975, Mateo Corporation filed a Form 1120, Corporation Income Tax Retur.., reflecting its principal business activity to be real estate investment. Each of the corporation's returns showed no gross receipts or income and reflected no interest expense or operating expense. The partnership returns for these years showed an ordinary loss for each of these years, the bulk of which represented interest expenses, with some business expenses from the operation of the complex. Each of the taxpayers claimed their distributive share of the loss reported by the partnership. Because Dr. Jones suffered a net operating loss in the taxable year 1974, he carried the loss back to his taxable years 1971 and 1972 and sought a refund based on the results of the carryback. In addition, Dr. Jones included in the carryback an unused investment credit for the taxable year 1974.

The Service in its statutory notices of deficiency, determined that Mateo Partnership was not entitled to deduct interest and business expenses for the taxable years in issue. The basis of the Service's determination

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7.4 *Compensation of the Corporate General Partner.* For its services in constructing, financing, operating and maintaining such improvements on the Partnership property, the Corporate General Partner shall be entitled to receive compensation in an amount equal to thirty (30) per cent of the Partnership's net profits, which compensation shall be paid to it not less frequently than annually. Such "net profits" shall be determined in accordance with generally accepted accounting principles applicable to the preparation of Federal income tax returns. Provided, however, that in determining such "net profits" there shall be excluded any capital gains realized by the partnership. The Corporate General Partner shall not be responsible for nor share any of the Partnership's losses, provided, however, that all such Partnership losses shall be carried forward, without limit as to time, in determining the Corporate General Partner's share of net profits.

was that the apartment complex to which the expenses related was owned and operated by the corporation. The Service further determined that the rental income from the operation of the apartment complex was not includible in the gross income of the partnership for the same reasons. Correspondingly, the Service determined that taxpayers were not entitled to deduct their pro rata shares of partnership losses which related to the interest and business expenses reported by the partnership. The Service increased taxpayers' taxable income for their respective taxable years to the extent of the interest and business expenses and decreased their taxable income to the extent of the rental income the partnership reflected in calculating its ordinary income for the taxable years 1974 and 1975. In addition, the Service made appropriate adjustments for Dr. Jones' taxable years 1971 and 1972, resulting from the elimination of his net operating loss carryback from 1974. The investment credit carryback likewise was denied by the Service.

The Tax Court agreed with the Service. It held that under the test of *Moline Properties v. Commissioner*, 319 U.S. 436, 63 S.Ct. 1132, 87 L.Ed. 1499 (1943), Mateo Corporation was formed for a business purpose and conducted business activity, and therefore had to be recognized as a separate taxable entity. As a separate taxable entity, only the corporation was entitled to the business and interest expenses deductions. The Tax Court also rejected the taxpayers' argument that Mateo Corporation was acting as an agent for Mateo Partnership. Applying the test of *National Carbide Corp. v. Commissioner*, *supra*—that for a corporation to be a true agent its relationship with its principal

must not be dependent on the fact that it is owned by the principal—the Tax Court held that the taxpayers had failed in their burden of proving the normal incidents of an agency relationship between the partnership and the corporation.

APPLICABLE LAW

The bulk of the Tax Court's opinion addresses the question of whether or not Mateo Corporation should be disregarded as a separate taxable entity. We have no quarrel with the Tax Court's conclusion that numerous Supreme Court, Fifth Circuit, and Tax Court decisions have established beyond peradventure that Mateo Corporation cannot be disregarded;[8] however,

8. *See Moline Properties, Inc. v. Commissioner of Internal Revenue*, 319 U.S. 436, 63 S.Ct. 1132, 87 L.Ed. 1499 (1943); *Evans v. Commissioner of Internal Revenue*, 557 F.2d 1095 (5th Cir. 1977); *Collins v. United States*, 386 F.Supp. 17 (S.D.Ga. 1974), *aff'd. per curiam*, 514 F.2d 1282 (5th Cir. 1975); *Britt v. United States*, 431 F.2d 227 (5th Cir. 1970); *Greer v. Commissioner of Internal Revenue*, 334 F.2d 20 (5th Cir. 1964); *Tomlinson v. Miles*, 316 F.2d 710 (5th Cir.), *cert. denied* 375 U.S. 828, 84 S.Ct. 71, 11 L.Ed.2d 60 (1963); *Strong v. Commissioner of Internal Revenue*, 66 T.C. 12 (1976), *aff'd. without opinion* 553 F.2d 94 (2d Cir. 1977); *Bolger v. Commissioner of Internal Revenue*, 59 T.C. 760 (1973), *acq.* 1976–1 C.B. 1; *Estate of Philip Lichstein*, 1962 T.C.M. ¶ 62,252 (P–H, 1962).

See also from other circuit courts: *Foglesong v. Commissioner of Internal Revenue*, 621 F.2d 865 (7th Cir. 1980); *Ogiony v. Commissioner of Internal Revenue*, 617 F.2d 14 (2d Cir. 1980), *cert. denied* —— U.S. ——, 101 S.Ct. 269, 66 L.Ed.2d 130 (1980); *Harrison Property Management Co. v. United States*, 201 Ct. Cl. 77, 475 F.2d 623 (1973), *cert. denied* 414 U.S. 1130, 94 S.Ct. 868, 38 L.Ed.2d 754 (1974); *Carver v. United States*, 412 F.2d 233 (Ct.Cl. 1969); *Given v. Commissioner of Internal Revenue*, 238 F.2d 579 (8th Cir. 1956).

Compare Paymer v. Commissioner of Internal Revenue, 150 F.2d 334 (2d Cir. 1945).

that is not an issue in this case. Taxpayers here do not seek, nor did they seek below, to disregard Mateo Corporation; nor do they argue that it should be treated as a sham or fictitious entity.[9] Taxpayers acknowledge, and indeed insist, that Mateo Corporation should be recognized. Taxpayers' argument is that Mateo Corporation is the corporate general partner of the limited partnership, that the partnership is the equitable owner of the real estate, and that Mateo Corporation properly held legal title, and performed other partnership functions, in its own corporate name without disclosing the fiduciary capacity. Taxpayers argue that the Service has recognized the form taxpayers adopted only partway; that is, taxpayers argue that the Service seeks to recognize the establishment of the corporation, but to disregard the status of the corporation as general partner in the limited partnership.

The issue before this court is whether the alleged relationship—i.e., Mateo Corporation as an undisclosed general partner of the limited partnership—shall be recognized for tax purposes despite legal title lying in Mateo Corporation.

[1, 2] When a taxpayer seeks to establish an agency relationship with a controlled corporation, the standards against which we test this relationship are established by the Supreme Court case, *National Carbide Corp. v. Commissioner of Internal Revenue*, 336 U.S. 422, 69

9. The Tax Court below was understandably misled because the courts have not sharply distinguished the fictitious entity argument from the agency argument relied upon by taxpayers in this case.

S.Ct. 726, 93 L.Ed. 779 (1949).[10] There a parent corporation entered into a contract with its four subsidiary corporations establishing each subsidiary as agent for the parent. The parent was to furnish working capital, management, and office facilities to the subsidiaries. In return, the subsidiaries were to turn over to the parent all profits in excess of 6% of the outstanding capital stock of the subsidiaries, which was nominal. The subsidiaries held title to the assets they used; the assets were purchased with monies advanced by the parent, which advances were shown on the subsidiaries' books as accounts payable to the parent. Those assets were worth nearly $20 million, and the number of employees of the subsidiaries was in the thousands. The Supreme Court held that the subsidiaries could not be deemed agents of the parent for tax purposes because the business arrangement between the parent and subsidiary arose only because the parent owned and completely dominated the subsidiaries. 336 U.S. at 438, 69 S.Ct. at 734. However, the Court made it clear that a wholly-owned corporation could be deemed an agent for tax purposes where the usual incidents of an agency relationship exist:

> Whether the corporation operates in the name and for the account of the principal, binds the principal by its actions, transmits money received to the principal, and whether receipt of income is attributable to

10. See Kronovet, *Straw Corporations: When Will They be Recognized; What Can and Should be Done*, 39 J.Tax. 54 (July, 1973), and Baker and Rothman, *Straw Corporations: New Cases Shed Light on Tax-Recognition Criteria*, 45 J.Tax. 84 (August, 1976), for surveys of cases in which legal title has been placed in a corporation and yet individual taxpayers argue that the corporation should be regarded as a sham or an agent.

> the services of the principal and to assets belonging to the principal are some of the relevant considerations in determining whether a true agency exists. If the corporation is a true agent, its relations with its principal must not be dependent upon the fact that it is owned by the principal, if such is the case. Its business purpose must be the carrying on of the normal duties of an agent.

336 U.S. at 437, 69 S.Ct. at 734 (footnotes omitted).

This circuit has rejected a similar agency argument in a case with facts quite close to those in the instant case. *Collins v. United States*, 386 F.Supp. 17 (S.D.Ga.1974), *aff'd. per curiam* 514 F.2d 1282 (5th Cir. 1975). In that case, tenants-in-common formed a corporation in order to avoid usury laws and to obtain interim and permanent financing for an apartment complex. The corporation had power to invest, develop and sell land in general, and was not limited to acting as agent. The co-tenants executed an agreement among themselves that the corporation would have power only to conduct activities required by the lender bank, would hold title as trustee only, would take no action other than that directed by the co-tenants, and the Board of Directors would have no authority except that required by law and the lenders. The corporation executed an agreement acknowledging its limited purpose and its duty to reconvey legal title as soon as consistent with the requirement of the lenders. The corporation executed the loan documents for the interim loan. This loan was guaranteed by the co-tenants as individuals. The construction contract was executed by the co-tenants. The corporation conducted no business activity other than maintaining a bank account to pay various

construction expenses. Despite the fact that loan documents were signed by a purported officer of the corporation, no stock was issued, no meeting of stockholders was held, and no directors ever elected. The corporation filed no tax returns. The taxpayers asserted, and the court did not dispute, that the lenders were aware they were dealing with the individuals and not the corporation. The district court, nevertheless, concluded the corporation was not an agent because its relationship to its principal was dependent on the fact that it was owned by the principal. This circuit affirmed. 514 F.2d at 1283, n.2.

Although the relationship in the instant case is that of a controlled corporate general partner to the limited partnership, as opposed to the alleged agency relationship in *National Carbide* and *Collins*, we think that the same standards apply.[11] Taxpayers do not seriously argue to the contrary.

[3] The burden of proving that the partnership relationship existed with respect to the ownership of the apartment complex is upon taxpayers. *Northern Natural Gas Company v. Commissioner of Internal Revenue*, 362 F.2d 781 (8th Cir. 1966). If conflicting inferences can be drawn from the evidence, the decision as to whether a partnership relationship existed for tax purposes is for the Tax Court. The findings of fact by

11. Of course, application of the standards will be somewhat different. For example, in the instant case, we will inquire whether the corporate general partner here functions in a manner consistent with the normal duties of a corporate general partner, whereas the *National Carbide* inquiry related to the normal duties of an agent. Similarly, we note below that the third *National Carbide* factor is not relevant in the instant case.

the Tax Court will not be disturbed unless such findings are clearly erroneous. *Northern Natural Gas Company v. Commissioner of Internal Revenue, supra; Greer v. Commissioner of Internal Revenue*, 334 F.2d 20 (5th Cir. 1964).

APPLICATION OF THE NATIONAL CARBIDE STANDARDS

We discuss in turn the application to the instant facts of the six *National Carbide* factors.

The first factor is whether the corporation operates in the name and for the account of the partnership. The record on this point is mixed. While FMI, Lakewood and Texas Bank all knew that Dr. Jones was a partner of Mateo Partnership, and while these lending institutions were first approached by Dr. Jones as partner of the partnership, there is no evidence indicating that these lending institutions understood that the corporation with which they ultimately dealt was a partner in Mateo Partnership. The loan documents executed for interim financing during the construction period were in the name of Mateo Corporation without disclosure of any fiduciary capacity. The record reflects that Mateo Corporation consistently dealt with the surety without disclosure of its fiduciary capacity. Leases, however, were entered into in the partnership name, and operating expenses of the complex were paid by the partnership. While the evidence is unclear as to whether the contractor even knew the existence of Mateo Partnership, it is clear that the contractor assumed he was dealing with Dr. Jones individually as opposed to Mateo Corporation with whom two contracts were entered. Even if the contractor is included among those

who knew the apartments were owned by Mateo Partnership, such knowledge would not serve to distinguish the cases which have applied the *National Carbide* standards. *Collins v. United States, supra* and *Harrison Property Management Co. v. United States*, 475 F.2d 623 (Ct.Cl. 1973), *cert. denied* 414 U.S. 1130, 94 S.Ct. 868, 38 L.Ed.2d 754 (1974), both involved partial disclosure of the true beneficial owner of property, and both found no agency status.[12]

[4] The second *National Carbide* element is whether the principal is bound by the alleged agent's actions. No party contests, and we conclude, that Mateo Partnership would be bound by all of the relevant actions of Mateo Corporation in the instant case. It is questionable, though, how much weight this element has in proving a true partnership relationship. Courts typically pass over this element, even though the facts in those cases give strong indication that the principal would be bound by the agent corporation's actions. *National Carbide v. Commissioner of Internal Revenue, supra; Collins v. United States, supra; Harrison Property Management Co. v. United States, supra.* The fact that the agency agreement is reduced to writing clearly is not conclusive that an agency relationship exists. *National Carbide v. Commissioner of Internal Revenue,*

12. In *Collins v. United States, supra,* this circuit rejected the agency argument even though the alleged principals entered into a construction contract for the construction of an apartment complex with a general contractor. Also, in *Collins,* the taxpayers claimed the lender knew it was dealing with individuals despite the use of a corporation to execute loan documents. The district court in its opinion did not reject this claim. In *Harrison Property Management Co. v. United States, supra,* the corporation and individual shareholders joined in suits and in signing leases.

supra; Collins v. United States, supra; Harrison Property Management Co. v. United States, supra; cf. Greer v. Commissioner of Internal Revenue, supra, (where a factor in finding no agency was lack of a written document evidencing the relationship.)

With respect to the third factor—whether Mateo Corporation transmitted monies to Mateo Partnership —we find no evidence in the record pointing specifically in either direction. However, we do not believe this factor is relevant in the instant case. In the normal agency relationship, a corporate agent would be expected to transmit the monies it collects to its principal. On the other hand, a general partner charged with constructing and managing an apartment complex would not transmit monies on a regular basis. The record shows that there was no significant cash which could have been distributed to the partners during the years at issue.

The fourth factor in *National Carbide* is whether receipt of the income is attributable to employees or assets belonging to Mateo Partnership. Services of employees of Mateo Corporation are not a significant factor in this case. Although record title was in the name of Mateo Corporation, there is no evidence to contradict the conclusion that true ownership of the property was in the partnership. The Service does not dispute the fact that the corporation was authorized by the partnership agreement to hold the property in its name without disclosure of the fiduciary capacity. Although there is no dispute that Mateo Partnership owns the equitable title, this factor also has counted for little in prior cases. In cases where an agency argument was made, it was undisputed that equitable title was in the

principal. Yet, the agency argument was rejected. *Collins v. United States, supra; Harrison Property Management Co. v. United States, supra. See also Bolger v. Commissioner of Internal Revenue*, 59 T.C. 760 (1973), *acq.* 1976–1 C.B. 1, (where agency argument rejected although facts strongly suggested equitable title in individuals). *See also Greer v. Commissioner of Internal Revenue, supra,* (where this circuit found no agency relationship in part because of ambiguity as to where true ownership of the leasehold involved there lay). Accordingly, we are bound to find that this element lends little weight to taxpayers' argument.

The fifth factor is whether Mateo Corporation's relationship with the partnership was dependent upon the fact that it was owned and controlled by the individual partners. Mateo Corporation was admittedly formed solely to obtain financing for the partnership and has performed no other business activity. The loan documents and construction contract had been signed in the corporation's name even before formation of the corporation. The record shows that the corporate general partner here would receive no compensation until net profits exceed the cumulative past losses, and thereafter would receive 30% of the partnership's net profits exclusive of capital gains. Receipt of 30% of the net profits would be a significant fact in favor of recognition of the partnership relationship. Taxpayers, however, have placed in the record no evidence concerning the likely amount Mateo Corporation would receive, the length of time Mateo Corporation would have to wait before it would begin receiving its share of net profits, and, most significantly, the reasonableness of the 30% share. Taxpayers have produced no

evidence to prove that the compensation payable to the corporate general partner was determined on an arms-length basis. Nor have taxpayers introduced any other evidence to prove that the relationship between the corporate general partner and the limited partnership was independent of the acknowledged ownership and control. Accordingly, we must conclude that taxpayers have failed to meet their burden of showing that Mateo Corporation's relationship with the partnership was an independent one.[13]

The last, but significant, criterion under *National Carbide* is whether Mateo Corporation's activities in the instant case are consistent with the normal duties

13. This *National Carbide* factor is in general harmony with the general principles of tax law. Ownership and control of a corporate general partner by the limited partners of a limited partnership is a factor, under Treas.Reg. § 301.7701-2(d)(2), in determining whether such a partnership would be taxable as an association. In Rev.Proc. 72–13, 1972–1 C.B. 735, the Service announced it would not give advance rulings on whether a limited partnership with a sole corporate general partner qualified as a partnership for tax treatment if the limited partners owned directly or indirectly more than 20% of the corporate general partner or any affiliate. These rules reflect a concern about abuse of the tax laws by limited partnerships utilizing controlled corporations as general partners. *See Zuckman v. United States*, 207 Ct.Cl. 712, 524 F.2d 729 (1975). This fifth *National Carbide* factor reflects a similar concern, albeit in a different context. *See also Walter F. Maxwell*, 29 T.C.M. 1356 (1970); *Charles Turner*, 24 T.C.M. 544 (1965); *Noonan* [*v. C. I. R.*], 52 T.C. 907 (1969), *aff'd. per curiam*, 451 F.2d 992 (9th Cir. 1971); McKee, Nelson and Whitmire, *Federal Taxation of Partnerships and Partners*. ¶ 3.04[2] (1977), suggesting that situations involving a shareholder entering into a partnership with a controlled corporation will be closely scrutinized, but will be recognized where both the shareholder and the corporation perform necessary and substantial functions or both have substantial, separate capital interests at stake in the venture.

of a general partner. Taxpayers have introduced no evidence in this regard. In particular, taxpayers have introduced no evidence to prove that corporate general partners commonly take title to real estate without disclosure of any fiduciary capacity.[14] We are mindful of the fact that the *National Carbide* test contains, as one of its factors, an inquiry into whether the agency was disclosed. There is no indication in this record that it is more common for a corporate general partner to act in an undisclosed capacity than for an agent to do so. Accordingly, we conclude that taxpayers have failed to carry their burden of proving that Mateo Corporation functioned in a manner consistent with the normal duties of a general partner.

[5] In summary, we conclude that the taxpayers here have carried their burden of proof only with respect to the second and fourth *National Carbide* factors, *i. e.*, that the partnership would be bound by the corporate general partners' actions, and that the income of the partnership would be attributable to property equitably owned by the partnership. However, these two factors have been present in numerous cases which have nevertheless rejected the taxpayer's agency argument. In particular, these factors were present in the *Collins* case, a previous decision of a panel of this court, which is binding upon us, and which rejected the agency

14. Taxpayers do cite four cases in which the Board of Tax Appeals stated that, although legal title to property was in the name of an individual partner, such property may nevertheless be deemed to belong to the partnership *W. H. Simmons*, 22 B.T.A. 1106 (1931), and X–2 C.B. 65 (1931); *Frank E. Eystone*, 10 B.T.A. 1232 (1928), *acq.* VII–2 C.B. 12 (1924) *Lewis Dill*, 3 B.T.A. 65 (1925), *acq.* IV–2 C.B. 2 (1925); *Theodore Levin*, 7 B.T.A.M. ¶ 36, 103 (1938).

argument. With respect to the first *National Carbide* factor, the evidence here is no more favorable to the taxpayer than was the evidence in *Collins*. We noted above that the third *National Carbide* factor is not relevant in the corporate general partner-limited partnership context of this case. Since taxpayers have failed to produce any evidence with respect to the crucial fifth and sixth *National Carbide* factors — whether the relationship was arms-length and independent, and whether the corporate general partner functioned in a manner consistent with the normal duties of a general partner — we have no sound basis on which to distinguish the *Collins* case. Accordingly, we conclude that taxpayers have failed to carry their burden of proof with respect to the *National Carbide* standards.[15]

AFFIRMED.

15. Because we find for the Service on the agency issue, and because the court below did not address the Service's argument that the interest deductions for the taxable years 1974 and 1975 are not deductible under this circuit's *en banc* decision, *Battelstein v. Internal Revenue Service*, 631 F.2d 1182 (5th Cir. 1980), we find no need to address the applicability of *Battelstein* to the instant facts.

B-1

George M. Jones and Jean H. Jones, et al.[1]

v.

Commissioner.

Filed November 7, 1978

Claude R. Wilson, Jr., 2300 Republic Nat'l Bank Tower, Dallas, Tex., for the petitioners, James R. Turton, for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

GOFFE, Judge: The Commissioner determined deficiencies in the Federal income tax of petitioners as follows:

Petitioners	Docket No.	Taxable Year	Deficiency
George M. and Jean H. Jones	4735-77	1971	$ 2,998.78
	2186-76	1972	4,412.63
	4512-76	1973	20,863.29
	4735-77	1974	23,279.59
		1975	23,020.67
Charles M. and Julia I. Wilson	5992-76	1973	$ 1,935.80
	4835-77	1974	3,063.89
		1975	3,336.42
Shields O. and Harriette L. Livingston	5993-76	1973	$ 1,707.66
	4734-77	1974	4,203.12
		1975	3,561.60
Robert G. and Francoise B. Long	5994-76	1973	$ 1,998.51
	5200-77	1974	4,209.37
		1975	3,353.50
Donald E. and Carol J. McGuire	5991-76	1973	$ 1,982.80
	4733-77	1974	4,209.87
		1975	3,354.07

[1] Cases of the following petitioners are consolidated herewith: Donald E. and Carol J. McGuire, docket No. 5991-76 and 4733-77; Charles M. and Julia I. Wilson, docket No. 5992-76 and 4835-77; Shields O. and Harriette L. Livingston, docket No. 5993-76 and 4734-77; and Robert G. and Francoise B. Long, docket No. 5994-76 and 5200-77.

Upon motion of the parties these cases were consolidated for purposes of trial, briefs, and opinion.

The issue for our decision is whether a corporation, San Mateo Properties, Inc., or a limited partnership, San Mateo Properties, Ltd. II, is entitled to claim income and expenses from the construction and operation of an apartment complex.

FINDINGS OF FACT

Some of the facts have been stipulated. The stipulation of facts and supplemental stipulation of facts along with the attached exhibits are incorporated by this reference.

Petitioner George M. Jones and his wife Jean H. Jones (hereinafter referred to as Dr. Jones) filed their joint Federal income tax returns for the taxable years 1971, 1972, 1973, 1974 and 1975 with the Internal Revenue Service Center at Austin, Texas.

Petitioner Charles M. Wilson and his wife Julie I. Wilson filed their joint Federal income tax returns for the taxable years 1973, 1974 and 1975 with the Internal Revenue Service Center at Austin, Texas, as did petitioners Livingston, Long, and McGuire for their respective taxable years 1973, 1974 and 1975. At the time of filing their respective petitions all petitioners resided at Dallas, Texas.

In 1969 petitioners formed a limited partnership, San Mateo Properties, Ltd. (hereinafter referred to as the partnership) for the purposes of developing and operating an apartment complex in the Dallas area.[2] Dr.

[2] Petitioners Livingston and McGuire became limited partners of San Mateo Properties, Ltd., for the first time during the taxable year 1973. An additional limited partner is not before this Court.

Jones purchased tracts of land which he contributed to the partnership. He became the general partner and as such received a 75 percent interest in the profits and losses of the partnership. The remaining petitioners contributed money and each received as a limited partner, a 5 percent interest in the partnership's profits and losses.

The partnership needed both permanent and interim financing to accomplish its purpose of developing an apartment complex. As a result Dr. Jones sought the necessary financing through various mortgage brokers who in turn attempted to locate a lending institution which was willing to negotiate a loan with San Mateo. In 1972, after changes in the architectural plans had been made, Dr. Jones contacted Texas Southwest Developers, Inc. (hereinafter Southwest) which secured permanent financing for the project by negotiating an agreement with First Mortgage Investors of Miami, Florida (hereinafter FMI). For their services Southwest received a fee in the amount of $13,500 from Dr. Jones.[3] The fee represented ½ percent of the total loan. FMI was willing to lend the partnership $2,700,000. As a result of further negotiations between the partnership and FMI, FMI agreed to lend only $2,350,000. Consequently, Dr. Jones negotiated a loan (a letter of credit) with Lakewood Bank and Trust for the additional amount of $350,000 needed for the project. Lakewood charged a fee in the amount of $3,500 for the letter of credit (1 percent of $350,000). During the negotiations with FMI and Lakewood Bank and Trust, the lending institutions informed Dr. Jones that they

[3] In addition, during 1973 a brokerage fee was paid to C. C. McLain for the purpose of locating permanent financing.

would be unable to consummate the loan agreements in the present form (i. e., an agreement with the partnership). Their reason for refusing to close the loan agreement with a partnership was based on the usury laws of Texas which limited interest rates on loans to individuals and partnerships. The lending institution agreed to make the loan only to a corporation. In response to this request, Dr. Jones and the limited partners of San Mateo formed in 1973 San Mateo Properties, Inc. (hereinafter referred to as the corporation). Upon the organization of the corporation, the limited partnership transferred by warranty deed certain real property it held which had been contributed by Dr. Jones. The business purpose of the corporation, as stated in its Articles of Incorporation was "to plan, arrange, construct, manage, and operate residential properties, duplexes, apartment complexes and other tenements of every kind and character either alone or in partnership or joint venture with others." In addition, the corporation entered into a limited partnership agreement (hereinafter referred to as San Mateo II) with Dr. Jones and the limited partners of the partnership. This agreement provided for two general partners (Dr. Jones and the corporation) with the remaining partners of the partnership as limited partners. Dr. Jones and the limited partners were the sole shareholders of the corporation.[4]

[4] Dr. Jones received a 75 percent interest in the losses of San Mateo II and the remaining petitioners, as limited partners received a 5 percent interest in their share of the losses. The corporation was not entitled to a distributive share of losses but San Mateo II agreed to compensate the corporation for its services 30 percent of the future net profits of the partnership. The record does not reflect that the corporation received any "compensation" during the taxable years in issue.

Following its organization the corporation entered into a loan agreement with FMI for the needed permanent financing whereby FMI agreed to lend $2,350,000 to the corporation and lend an additional amount of $350,000 when the apartments to be constructed reached 85 percent occupancy. The corporation then obtained a letter of credit from Lakewood Bank and Trust.[5].

After the corporation secured permanent financing it sought interim financing by contacting Texas State Mortgage, Inc., which negotiated an agreement with Texas Bank and Trust. During 1973 Texas Bank and Trust agreed to lend the corporation interim financing in the amount of $2,700,000. Dr. Jones, as president of the corporation, signed the loan agreement as guarantor. Expense fees in the amount of $49,063.08 were paid in 1973 to Texas Bank and Trust in order to obtain the interim financing.[6]

The corporation then entered into a construction contract with Campbell Bros., Inc., which agreed to build an apartment complex on the property the partnership had contributed to the corporation. Under the contract the corporation agreed to pay Campbell Bros., Inc., approximately $2,700,000. As the construction

[5] In 1973 legal fees in the amount of $276.10 were paid to a law firm for preparing the necessary documents to obtain the letter of credit.

[6] During 1973 Dr. Jones paid Dallas Title Company $1,201 for the purpose of documenting clear title to the property on which the apartments where built. Texas Bank and Trust required this documentation pursuant to the interim financing agreement with the corporation. In addition, the corporation paid an attorney for services rendered in preparing the necessary legal documents related to the loan from Texas Bank and Trust.

progressed various alterations were made with respect to the design and size of the complex. These changes were made and agreed upon by both Campbell Bros. and the corporation, through its president Dr. Jones. The alterations of the complex were documented by "change orders" which reflected the corporation as owner of the complex.[7]

For the taxable years 1974 and 1975 the corporation made interest payments to Texas Bank and Trust pursuant to the interim financing loan agreement in the respective amounts of $165,532.13 and $81,730.13. The interest payments were made on a monthly basis as the interest costs were presented by Texas Bank and Trust to Dr. Jones in his capacity as president of the corporation. Texas Bank and Trust lent additional amounts to satisfy the interest payments by depositing the appropriate amount each month in the corporation's account. Dr. Jones would then issue a corporate check payable to the bank in the amount of interest which was due that particular month.

During 1974 Texas Bank and Trust informed Dr. Jones that FMI was no longer a viable enterprise and that it would be necessary for the corporation to obtain permanent financing from another lending institution. Dr. Jones sought the services of a mortgage broker, Robert L. Seigel and Associates, for the purpose of obtaining permanent funding to complete the construction of the apartment complex. While Seigel and Associates was unable to obtain the needed permanent

[7] As individual apartments were completed San Mateo II entered into lease agreements with prospective tenants. The rental proceeds flowing from such leases were deposited in an account of San Mateo II.

financing, it was paid $1,500 in 1975 for its services. Texas Bank and Trust later was able to obtain the funds for the corporation.

On its Federal Partnership Return of Income for the taxable year 1972 San Mateo II reported an ordinary loss in the amount of $14,666.10. A portion of this reported loss represented an "interest expense" in the amount of $13,500 which had been paid to Southwest. The balance represented ad valorem taxes and miscellaneous deductions. Petitioners Jones claimed the entire amount ($14,666.10) on their joint Federal income tax return for the taxable year 1972, as their share of the partnership loss.

On its Federal Partnership Return of Income for the taxable year 1973 San Mateo II reported an ordinary loss of $81,168.35 a portion of which represented "interest expenses" paid as follows:

Texas State Mortgage, Inc.	$13,500.00
Texas Bank and Trust	49,063.08
Lakewood Bank and Trust	3,500.00
C. C. McLain	11,500.00
Dallas Title Co.	1,201.00
TOTAL	$78,764.08

In addition, the reported loss represented legal and accounting expenses in the amount of $2,047.30. Petitioners claimed the following distributive share of partnership losses for the taxable year 1973:

Petitioners	Amount Claimed
Jones	$60,876.25
Wilson	4,058.00
Livingston	4,058.42
Long	4,058.42
McGuire	4,058.00

For the taxable year 1974 San Mateo II reported an ordinary loss of $168,395.17 a portion of which represented an interest payment to Texas Bank and Trust in the amount of $165,532.13. In addition, the reported loss represented business expenses from the operation of the apartment complex in the amount of $14,380.99 and rental income from completed apartments in the amount of $11,517.95.

Petitioners claimed their distributive share of San Mateo II losses for the taxable year 1974 as follows:

Petitioners	Amount Claimed
Jones	$126,296.37
Wilson	8,420.00
Livingston	8,419.76
Long	8,419.76
McGuire	8,419.76

Dr. Jones reported a net operating loss in the amount of $61,396.35 for the taxable year 1974. He then carried the loss back to the taxable years 1971 and 1972 and sought a refund based on the results of the carryback. In addition Dr. Jones included in the carryback an unused investment credit for the taxable year 1974 in the amount of $90.30.

For the taxable year 1975 San Mateo II reported an ordinary loss in the amount of $134,162.90, a portion of which represented business expenses from the operation of the apartment complex in the amount of $132,772.83 and interest expenses paid to Texas Bank and Trust in the amount of $81,730.13. In addition, the reported ordinary loss included an offset of rental income from the operation of the apartment complex in the amount of $80,340.06.

Petitioners claimed as their distributive share of partnership losses for the taxable year 1975 as follows:

Petitioners	Amount Claimed
Jones	$100,622.20
Wilson	8,420.00
Livingston	6,708.14
Long	6,708.00
McGuire	6,708.14

The Commissioner, in his statutory notices of deficiency, determined that San Mateo II was not entitled to deduct interest and business expenses for the taxable years in issue (1972, 1973, 1974, and 1975). The basis of the Commissioner's determination was that the apartment complex and the property on which it was built (to which the expenses related) was owned and operated by the corporation (San Mateo Properties, Inc.). The Commissioner further determined that the rental income from the operation of the apartment complex was not includible in the gross income of San Mateo II for the same reasons. Correspondingly, the Commissioner determined that petitioners were not entitled to deduct their pro rata shares of partnership losses which related to the interest and business expenses reported by San Mateo II. Therefore, the Commissioner increased petitioners' taxable income for their respective taxable years to the extent of the interest and business expenses and decreased their taxable income to the extent of the rental income San Mateo II reflected in calculating its ordinary income for the taxable years 1974 and 1975. In addition, the Commissioner determined that because Dr. Jones did not have a net operating loss for the taxable year 1974 (due to the Commissioner's denial of Dr. Jones' reported pro

rata share of partnership losses) he was not entitled to a net operating loss carryback to the taxable years 1971 through 1972. The investment credit carryback likewise was denied by the Commissioner.

OPINION

The issue for our decision is whether certain losses are deductible by the respective petitioners as their pro rata share of partnership losses for the taxable years in issue or whether the losses are those of the corporation and, thus, not deductible by petitioners.

During the latter part of 1969 petitioners organized a limited partnership for the purpose of developing and operating an apartment complex. Dr. George Jones and his wife contributed property while the remaining petitioners contributed money. Following the organization of the partnership various architectural changes were made with respect to the design of the apartment complex. In 1972 Dr. Jones, in his capacity as general partner, sought financing with respect to the construction of the apartments. Due to the nature of the partnership's activities it was necessary to obtain permanent as well as interim financing. In both instances, various lending institutions informed Dr. Jones that they would be unable to lend the needed money to a partnership due to the usury laws of Texas. As a result, petitioners organized the corporation under the laws of the State of Texas for the purpose of obtaining the necessary financing of the apartment project and the construction and operation of the apartment complex. Petitioners transferred by warranty deed the property which had been held under the limited partnership and in return received stock in the newly organized corpo-

ration. The corporation then obtained the financing to begin construction of the apartments. In addition, Dr. Jones, in his capacity as director and president of the corporation entered into a construction contract with Campbell Bros., Inc., for the purpose of constructing the desired apartments. During the course of construction various changes in design were made. On each occasion Campbell Bros., Inc., and Dr. Jones, as president of the corporation, agreed on the design changes. As portions of the apartment were completed, individual units were rented by San Mateo II and all rental fees were deposited into its bank account.

For the taxable years 1972 through 1975 San Mateo II calculated its ordinary income by including the rental income from the apartments and deducting interest expense which related to the construction and operation of the apartment complex. As a result of this San Mateo II reported a loss for each such taxable year. Correspondingly, the petitioners deducted their shares of its losses.

Respondent takes the position that none of petitioners is entitled to a partnership loss deduction for the taxable years 1972, 1973, 1974, and 1975 because the corporation is entitled to claim the income and expenses from the construction and operation of the apartment complex. In substance respondent argues that the corporation should be recognized as a separate taxable entity and as such is entitled to deductions for the business and interest expenses paid for the financing, construction and operation of the apartment complex.

Generally, a corporate entity will not be ignored, except in unusual circumstances. *Britt v. United States*

[70-1 USTC ¶ 9400], 431 F. 2d 227 (5th Cir. 1970). The principal exceptions are when the corporation is a sham and when the corporation has been created for the purpose of tax avoidance. *Britt v. United States, supra.* In *Moline Properties v. Commissioner* [43-1 USTC ¶ 9464], 319 U. S. 436 (1943), the Supreme Court set forth criteria for recognition or non-recognition of a corporate entity by stating:

> The doctrine of corporate entity fills a useful purpose in business life. Whether the purpose be to gain an advantage under the law of the state of incorporation or to avoid or to comply with the demands of creditors or to serve the creator's personal or undisclosed convenience, so long as that purpose is the equivalent of business activity or is followed by the carrying on of business by the corporation, the corporation remains a separate taxable entity. * * * [Footnotes omitted.] [319 U.S. at 438-439.]

Therefore *Moline* established a two-prong test, the first part being business purpose and the second part business activity. *Collins v. United States* [75-1 USTC ¶ 9146], 386 F. Supp. 17 (1974), affd. [75-2 USTC ¶ 9553] 514 F. 2d 1282 (5th Cir. 1975). Business purpose and business activity are *alternative* requirements. *Tomlinson v. Miles* [63-1 USTC ¶ 9439], 316 F. 2d 710 (5th Cir. 1963).

Clearly the "business purpose" test is present in the facts of the instant case. Petitioners formed the corporation for the purpose of obtaining the necessary financing to construct the apartment complex. Due to the usury laws of Texas, lending institutions would not finance the project by lending the necessary funds to individuals or partnerships. The organization of the

corporation enabled petitioners to accomplish what they could not do as individuals or partners. We have previously held that the avoidance of restrictions under state law constitutes a valid business purpose which requires the recognition of the corporate entity. *Strong v. Commissioner* [Dec. 33,748], 66 T. C. 12 (1976), affd. 553 F. 2d 94 (2d Cir. 1977), an unreported opinion, 39 AFTR 2d 77-934, 77-1 USTC ¶ 9340; *Bolger v. Commissioner* [Dec. 31,883], 59 T. C. 760 (1973). In addition, the Fifth Circuit Court of Appeals recognized a valid business purpose where taxpayers incorporated to avoid state usury laws. *Collins v. United States, supra.* In *Collins*, the Court stated:

> I do not perceive how plaintiffs can maintain that Bencap, Inc. was only a fictive creature (a dummy or straw corporation) to be ignored when it came to the tax advantages of the individuals arising out of a business venture that would not have fructified without the use of the corporate device in connection with the temporary financing of the project. * * * [386 F. Supp. at 21.]

Moreover, the corporation negotiated a construction contract with Campbell Bros., Inc. and on numerous occasions changed the design and size of the complex. While its business activities were not extensive, they were sufficient to enable it to carry out the purpose for which it was created.

Petitioners take the position that the corporation was a "viable" corporation during the taxable years in issue. However, petitioners argue that for purposes of obtaining the loan and entering into the construction contracts, the corporation acted as the agent of the limited partnership. Therefore, the corporation acted as a mere

conduit. The Supreme Court dealt with a similar argument in *Moline* where it stated:

> the mere fact of the existence of a corporation with one or several stockholders, regardless of the corporation's business activities, does not make the corporation the agent of its stockholders. * * * [319 U. S. 440.]

The Supreme Court again stated its position in *National Carbide Corp. v. Commissioner* [49-1 USTC ¶ 9223], 336 U. S. 422 (1949). In *National Carbide* the Court stated that if a corporation is a true agent, its relationship with its principal must not be dependent upon the fact that it is owned by the principal. 336 U.S. 437. Therefore, in order for petitioners to prevail, they must demonstrate the existence of the normal incidents of an agency relationship between the limited partnership and the corporation under the tests of *Moline* and *National Carbide*. Petitioners have failed to meet their burden of proof because the existence of the corporation was totally dependent upon the fact that it was owned and controlled by petitioners. Moreover, the fact that the corporation was a partner with petitioners does not negate petitioners' total dominance of the corporation. *Stillman v. Commissioner* [Dec. 32,134], 60 T. C. 897 (1973).

Petitioners chose the advantages of doing business in the corporate form and correspondingly they must accept the tax disadvantages. *Strong, supra; Harrison Property Management Co. v. United States* [73-1 USTC ¶ 9292], 475 F. 2d 623 (Ct. Cl. 1973). Accordingly, San Mateo II is not entitled to deduct the interest and business expenses which related to the construction and operation of the apartment complex. As a result, peti-

tioners are not entitled to deduct their pro rata share of San Mateo II losses which relate to such expenses for the taxable years in issue. Having found for respondent we need not address ourselves to his alternative arguments relating to this issue.

Respondent further argues that the mortgage fees, loan fees, legal fees, and title policy fees incurred to obtain the loans for the construction of the apartment complex are not deductible but must be amortized over the life of the loans. This argument appears for the first time in respondent's opening brief. Neither the statutory notices of deficiency, nor respondent's pleadings raise this argument as an issue in the instant case. Moreover, respondent in his opening argument at trial, took the position that the issue for our decision related to whether the corporation or the limited partnership was entitled to deduct certain interest and business expenses and in the alternative whether petitioners could deduct interest expenses on a loan when the funds used to pay the interest were borrowed from the same lending institution. With respect to respondent's alternative argument, this Court ruled that respondent had assumed the burden of proof and allowed him to amend his pleadings accordingly. This he did. However, for reasons known only to respondent, he declined to plead facts relating to the question of deductibility versus amortization. Therefore, we decline to speak to this alternative argument of respondent. Cf. *Sanderling, Inc. v. Commissioner* [Dec. 33,939], 66 T. C. 743 (1976); *Ronan State Bank v. Commissioner* [Dec. 32,534], 62 T. C. 27 (1974); *Estate of Falese v. Commissioner* [Dec. 31,517], 58 T. C. 895 (1972); *Wild v. Commissioner* [Dec. 26,879], 42 T. C. 706 (1964).

We, therefore, sustain respondent's determination as stated in his statutory notices of deficiency.

Decisions will be entered for the respondent.

C-1

IN THE

United States Court of Appeals

FOR THE FIFTH CIRCUIT

UNIT A

No. 79-1420

GEORGE M. AND JEAN H. JONES,
DONALD E. AND CAROL J. McGUIRE
CHARLES H. AND JULIA I. WILSON,
SHIELDS O. AND HARRIETTE L.
LIVINGSTON, AND ROBERT G. AND
FRANCOISE B. LONG
Petitioners-Appellants,

versus

COMMISSIONER OF INTERNAL REVENUE,
Respondent-Appellee.

Appeal from the Decision of the Tax Court of the United States

ON PETITION FOR REHEARING
AND PETITION FOR REHEARING EN BANC

(Opinion March 27, 1981, 5 Cir., 198 , F.2d).

(May 19, 1981)

Before HILL, RUBIN AND ANDERSON, Circuit Judges.

PER CURIAM:

(✓) The Petition for Rehearing is DENIED and no member of this panel nor Judge in regular active service on the Court having requested that the Court be polled on rehearing en banc, (Rule 35 Federal Rules of Appellate Procedure; Local Fifth Circuit Rule 16) the Petition for Rehearing En Banc is DENIED.

ENTERED FOR THE COURT:

/s/ R. LANIER ANDERSON III

United States Circuit Judge

Opposition

Office - Supreme Court
FILED
SEP 30

No. 81-302

In the Supreme Court of the United States

OCTOBER TERM, 1980

GEORGE M. JONES, ET AL., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

REX E. LEE
Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 633-2217

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In the Supreme Court of the United States

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COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

The sole issue in this federal income tax case is whether the decision below correctly held that a corporation created by petitioners to obtain financing for, construct, manage, operate and hold title to an apartment complex was the taxable entity to which losses from the project are attributable for tax purposes.

The pertinent facts may be summarized as follows: In 1969, petitioners formed a partnership for the purpose of constructing and operating rental apartments on certain undeveloped land in the Dallas, Texas, area. They were unable to obtain loans for the apartment complex because the market interest rate for mortgage financing was in excess of the maximum rate chargeable to individuals under the usury laws of Texas. Loans were available, however, to corporations at a higher interest rate. Accordingly, petitioners formed a corporation (San Mateo Properties, Ltd.)

to borrow the necessary funds (Pet. App. A-2 to A-4, B-2 to B-4). The partnership then transferred title in the parcel of land it intended to develop to the corporation,[1] and the corporation became the mortgagor of record on both the interim and permanent loans.[2] The corporation, in addition, was made a general partner in the partnership.[3]

The corporation thereafter proceeded to execute a contract for the construction of the apartment complex. The corporation had sole control over the construction and operation of the complex, and it frequently submitted change orders to the contractor as construction progressed (Pet. App. A-6). At one point the corporation, through its attorneys, notified the contractor and the surety that it intended to take over the project if certain construction problems were not alleviated. Although the problems were eventually solved, the corporation found it necessary to borrow additional monies to complete the project (Pet. App. A-7 to A-8).

On their individual income tax returns for 1973 through 1975, petitioners claimed distributive shares of net operating losses reported by the partnership in connection with the operation of the apartment complex. On audit, the Commissioner of Internal Revenue disallowed the claimed losses on the ground that they could only be claimed by the

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[1]Title stood in the corporation's name without disclosure of any fiduciary relationship between the corporation and the partnership (Pet. App. A-6).

[2]During the loan negotiations for interim financing of the project, petitioners never advised the bank that the corporation was acting as an agent of the partnership (R. 41). The bank, in fact, would not have made interim construction loans to noncorporate entities at that time (R. 43). ("R." refers to the original record filed in the court of appeals.)

[3]According to the terms of the partnership agreement, the corporation was to receive 30% of the partnership's net profit (excluding capital gains), but was not to share in any of the losses (Pet. App. A-6).

corporation and not by the partnership (Pet. App. B-7 to B-10). In this suit brought by petitioners for redetermination of the resulting deficiencies, the Tax Court, applying the principles of *Moline Properties, Inc.* v. *Commissioner*, 319 U.S. 436 (1943), and *National Carbide Corp.* v. *Commissioner*, 336 U.S. 422 (1949), held that petitioners' controlled corporation was the proper entity to report the income and expenses generated from the construction and operation of the apartment complex (Pet. App. B-10 to B-16). The court of appeals affirmed. It held that the corporation was the owner of the apartment complex and that, under the circumstances of this case, it was not merely an agent of the partnership (Pet. App. A-11 to A-22).

1. The decision below correctly held that the losses in question were deductible only by the corporation and not by the partnership. It is well settled that if a corporation is organized for a business purpose, or if it engages in business activity, it must be recognized for tax purposes. *Moline Properties, Inc.* v. *Commissioner, supra.* The cases following *Moline Properties* have generally held that income or losses from property properly belong to the corporate owner unless the corporation is purely passive. *Ogiony* v. *Commissioner*, 617 F. 2d 14 (2d Cir.), cert. denied, 449 U.S. 900 (1980) (corporation formed to obtain real estate loan was proper entity to report income and losses from the venture); *Strong* v. *Commissioner*, 66 T.C. 12 (1976), aff'd without opinion, 553 F. 2d 94 (2d Cir. 1977) (same); *Collins United States*, 386 F. Supp. 17 (S.D. Ga. 1974), aff'd per curiam, 514 F. 2d 1282 (5th Cir. 1975) (same). See *Harrison Property Management Co.* v. *United States*, 475 F. 2d 623, 626 (Ct. Cl. 1973).

Here, the corporation was decidedly not passive. It was formed to circumvent the Texas usury law and to secure financing for construction of an apartment complex. The corporation, therefore, served a valid business purpose, if

not a business necessity. See *Ogiony* v. *Commissioner, supra,* 617 F. 2d at 16; *Collins* v. *United States, supra,* 386 F. Supp. at 21; *Bolger* v. *Commissioner,* 59 T.C. 760, 766 (1973). Moreover, the actual borrowing of funds by the corporation was undisputably a business activity, as was its ownership of the property during construction and its overall supervision of the project. See *Strong* v. *Commissioner, supra,* 66 T.C. at 25; *Collins* v. *United States, supra.* Accordingly, under *Moline Properties* and its progeny, the corporation in this case is a separate taxable entity which is required to recognize the income and losses derived from its property. Petitioners may not claim the losses of that corporation on their own returns.

2. Petitioners contend (Pet. 5-10) that their controlled corporation was acting merely as the corporate general partner[4] of their partnership, and, as such, earned income and sustained losses solely as the agent of the partnership. But under the circumstances here, that agency argument is "basically the same argument of identity in a different form." *Moline Properties, Inc.* v. *Commissioner, supra,* 319 U.S. at 440. Accord, *Stillman* v. *Commissioner,* 60 T.C. 897 (1973). A corporation normally will not be considered an agent or conduit where it has engaged in commercial activities with third parties and incurred legal obligations and responsibilities. *Britt* v. *United States,* 431 F. 2d 227, 236 (5th Cir. 1970).

The question whether a corporation engaging in business may escape taxation by describing itself as the agent of its owners was considered in *National Carbide Corp.* v. *Commissioner, supra.* In that case, a wholly-owned subsidiary was formed, and it was provided by contract that it

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[4]Dr. George M. Jones, one of the petitioners, also served as a general partner (Pet. App. A-3).

would function as an agent for its parent. The parent furnished all funds to the subsidiary for purchasing assets and for working capital, and all income of the subsidiary was treated as income of the parent. The subsidiary, however, held title to the assets. On these facts, this Court held that the subsidiary was a separate taxable entity despite the fact that it was "clothed in the garb of agency" (336 U.S. at 430). A corporation can escape taxation as the agent of another only if the corporation's "relations with its principal * * * [are] not * * * dependent upon the fact that it is owned by the principal" (*id.* at 437).

Here, the corporation's purported agency status was grounded solely on petitioners' ownership and control over it, and its business purpose was not "the carrying on of the normal duties of an agent" (336 U.S. at 437). Indeed, the existence of an agency relationship would have been self-defeating in this case since the bank furnishing the construction financing would not have made the loan if the corporation was acting merely as an agent of petitioners or their partnership (R. 41-43). See *Bolger* v. *Commissioner, supra,* 59 T.C. at 766. The corporation, moreover, did not operate its business dealings in the name of and for the account of the partnership (Pet. App. A-16 to A-17). Thus, the court of appeals correctly rejected petitioners' claim that the corporation here could be ignored for tax purposes on the ground that it was acting merely as their agent.

3. Contrary to petitioners' further claims (Pet. 6-8), the decision below does not conflict with *Commissioner* v. *Culbertson,* 337 U.S. 733 (1949), or the authorities that have followed it. Petitioners belabor a point never raised in this case. The issue of partnership existence, which was the focus of the Court's decision in *Culbertson,* has never been challenged by the Commissioner or either of the courts below. Rather, the issue here is whether petitioners' controlled corporation—which owned title to the real estate in question, borrowed money to finance construction of

improvements thereon, and otherwise controlled the project—can be ignored for tax purposes because of its purported status as an agent. The result below does not deny the *existence* of the partnership, as petitioners state (Pet. 5-10), but simply denies that the partnership is the proper entity to claim the deductions in question. Accordingly, the court below properly applied the guidelines established in *National Carbide* to the facts of this case.[5]

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

REX E. LEE
Solicitor General

SEPTEMBER 1981

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[5]Applying the same criteria, the Tax Court recently found, on different facts, that a corporation formed to avoid state usury laws was not the owner of property to which it had title, but, rather, acted as the agent of a partnership. *Roccaforte* v. *Commissioner*, 77 T.C. No. 22 (Aug. 10, 1981).

DOJ-1981-09